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Nos. 04-805, 04-814

IN THE

Supreme Court of the United States

TEXACO INC.,

Petitioner,

v.

FOUAD N. DAGHER, *et al.*,

Respondents.

SHELL OIL COMPANY,

Petitioner,

v.

FOUAD N. DAGHER, *et al.*,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF FOR PETITIONER TEXACO INC.

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REPLY BRIEF FOR PETITIONER TEXACO INC.

In our opening brief (at 11-26), petitioner Texaco demonstrated that the Ninth Circuit erred in treating the pricing of Equilon's gasoline as concerted action subject to Section 1 of the Sherman Act. When a joint venture or its owners set the price of the venture's own output in a market in which the owners no longer compete, that conduct is necessarily single firm conduct, and cannot properly be treated as an ongoing daily conspiracy. Pricing decisions for such jointly produced output do not deprive the economy of independent decisionmakers or increase any market power. Once the venture itself is validly formed (and the Ninth Circuit here did not question the validity of the formation of this joint venture, which indisputably achieved substantial real efficiencies and was extensively reviewed and found valid by federal and state regulators), the venture is entitled to operate its business as would any other entity, without its every production or marketing decision being second-guessed under the antitrust laws as supposedly unreasonable or unnecessary. This Court's decisions recognize as much, and respected commentators agree.

As we further demonstrated in our opening brief (at 26-37), even if Section 1 review is available in these circumstances, *per se* condemnation of the joint venture's operation is plainly improper. *Per se* treatment is reserved for those few agreements that experience has taught are plainly anticompetitive and economically unwarranted because they directly eliminate otherwise existing competition without offsetting economic benefit. Here, Equilon's pricing decisions did not eliminate competition, because they were made with respect to Equilon's own gasoline as to which the venture's valid formation had already ended competition. Subjecting such decisions to *per se* illegality would effectively prohibit the formation of production and marketing ventures such as this one and deprive the economy of beneficial collaborative activities that this Court and others have recognized produce real consumer benefits.

None of the arguments that respondents or their amici advance in their opposing briefs casts any doubt on these points of law. Indeed, recognizing the indefensibility of the Ninth Circuit's ruling, respondents and their amici advance several arguments that abandon the Ninth Circuit's reasoning and ask the Court to affirm on other grounds. The new arguments, however, are no more valid than the old ones.

I. RESPONDENTS ERR IN SUGGESTING THAT THE PRICING OF JOINT VENTURE OUTPUT BY THE VENTURE OR ITS OWNERS IS *PER SE* ILLEGAL.

A. The *Per Se* Rule Does Not Apply To Pricing Of A Jointly Owned Product As To Which Competition Has Validly Been Ended.

Respondents begin their argument in favor of application of the *per se* rule by suggesting (Resp. Br. 18-20) that this Court's decision in *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969), forecloses any other analysis of the matter. *Citizen Publishing* obviously does not do so.

In *Citizen Publishing*, the newspapers' venture had neither fully combined the operations of its owners nor eliminated competition between them in the relevant market. Rather, the newspapers had retained their separate news and editorial departments and, in setting their advertising and subscription rates, the newspapers were not setting the price for a jointly produced product (but were agreeing on prices for their separate products as to which they remained in competition). In contrast, here, Texaco and Shell fully combined their respective refining and marketing assets in the relevant markets and themselves exited from competition in these markets; in setting the price of Equilon's production, they were thus no longer acting as separate competitors but rather as joint owners of a single entity. Moreover, unlike this case (in which the Ninth Circuit did not question the legitimacy of the integration of Shell's and Texaco's operations), *Citizen Publishing* ruled that the newspapers could not have validly

integrated their operations. 394 U.S. at 134-35. Thus, *Citizen Publishing* is not only not controlling, it has very little application here, since it dealt with the fundamentally distinct situation in which two competitors have fixed the prices of products that they have not, and could not validly have, jointly produced.

There is also a historical, and resulting doctrinal, reason that *Citizen Publishing* is unhelpful to the analysis here. That decision was rendered in an era in which the Court took a very different approach to antitrust issues generally and to the analysis of joint ventures in particular. Of special significance, *Citizen Publishing* was decided before the Court's rulings in cases such as *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1 (1979) ("*BMI*"), and *NCAA v. Board of Regents*, 468 U.S. 85 (1984), where the Court adopted a much more nuanced approach to restraints associated with joint ventures. In *BMI*, for example, the venture had set the price for the venture's blanket license. But this Court rejected the *per se* rule as inappropriate, even though (unlike here) the venture participants remained competitors in the same market. That result applies *a fortiori* here, where the pricing decision did not fix the price of any products that remained in competition. Yet respondents would have the Court read *Citizen Publishing* without regard to either later cases such as *BMI* or the Court's evolving approach to joint ventures and related antitrust issues.

Respondents complain (Resp. Br. 19, 33) that this case involves a "price-fixing" agreement that "was secret" and that *per se* treatment is required because they challenge a "direct restraint on price." But this complaint rests on the very "overly simplistic" literalism that this Court rejected in *BMI*, 441 U.S. at 9. The question is not whether a price has been jointly set. The question is whether setting the price has restrained competition that would otherwise exist. Here, no such restraint existed because competition between the two companies had already been ended in this market by virtue of Equilon's formation and the complete, efficiency-

enhancing integration of Shell's and Texaco's gasoline businesses in the United States. Respondents do not, and cannot, cite any authority for applying the *per se* rule where the agreement at issue is between the owners of jointly produced products as to which competition has validly been ended. In such circumstances, the rationale for *per se* illegality—*i.e.*, that the restraint at issue is one that "always or almost always tend[s] to restrict competition and decrease output," *BMI*, 441 U.S. at 19-20—is inapplicable.

The linchpin of this Court's cases applying the *per se* rule against price-fixing agreements is the "absence of competition secured by the agreement." *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397 (1927); *see id.* ("The aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition."). Here, the decision by Equilon (or its owners) as to the price for Equilon's gasoline did not secure the absence of competition. It was simply the pricing of products that were already jointly owned and thus not in competition. There is no basis for subjecting them to Section 1 scrutiny at all, much less for condemning them as *per se* illegal.

Respondents thus also err in suggesting (Resp. Br. 33-44), that *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332 (1982), and *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951), support application here of the *per se* rule. In *Maricopa County*, the pricing decisions were held to be *per se* unlawful because the doctors in issue there had *not* validly ended relevant competition by forming a cooperative enterprise in which they "pool[ed] their capital and share[d] the risks of loss as well as the opportunities for profit." 457 U.S. at 356. Had they done so, as Shell and Texaco did here, the Court recognized that a decision among them setting the price for their joint product "would be perfectly proper." *Id.* at 357. And, like the doctors in *Maricopa County*, the corporations in *Timken* had not integrated their operations into a new venture, but had simply reached horizontal agreements regarding the prices of their separately produced

and competing products. Respondents thus do not and cannot gain support from either decision.

Respondents' reliance on *BMI* is similarly misplaced. The fact that the copyright holders there continued to sell individual licenses was relevant because, absent the availability of such individual licenses, the challenged blanket licenses would have been the exclusive means of purchasing virtually any copyrighted work. *See BMI*, 441 U.S. at 5 ("[a]lmost every domestic copyrighted composition is in the repertory" of the defendants). Equilon enjoyed no such control over domestic gasoline, but faced numerous, significant competitors. That was the reason, in combination with the efficiencies that Equilon's formation would create, that the FTC permitted Equilon to be formed to produce and market gasoline. And, once validly formed, Equilon and its owners were entitled to set a price for its products on the same basis that BMI and ASCAP were allowed to set the price for their joint products. Indeed, whereas rule of reason analysis was appropriate in *BMI*, because the copyright holders remained in competition in the market, here Section 1 scrutiny is not appropriate at all, because Shell and Texaco no longer compete in the relevant market.

Respondents emphasize (Resp. Br. 35-36) that the blanket licenses in *BMI* were a "new product" that individual copyright holders could not have produced on their own. But procompetitive, efficiency-creating ventures are not limited to those that create new products. As in this case, joint ventures can create efficiencies in producing and marketing existing products by eliminating redundancies, creating economies of scale, and sharing risk. *See* Tex. Br. 25 n.13. Even the Ninth Circuit recognized that "[t]here is a voluminous record documenting the economic justifications for creating the joint ventures" here. Pet. App. 4a. That being the case, no basis exists for Section 1 scrutiny of—much less for condemning as *per se* illegal—the operation of Equilon's validly formed business. As *BMI* itself stated, "[w]hen two partners set the price of their goods or services

they are literally 'price fixing,' but they are not *per se* in violation of the Sherman Act." 441 U.S. at 9.

B. Respondents Err in Suggesting That "Ancillary Restraint" Jurisprudence Requires Joint Venturers To Prove The "Necessity" Of Pricing Decisions About Their Jointly Owned Products.

Finding no support for their argument in this Court's *per se* rule jurisprudence, respondents next erroneously seek refuge in the so-called "ancillary restraint" jurisprudence. Specifically, respondents argue (Resp. Br. 38-41) that, under "ancillary restraint" cases, *per se* treatment is proper unless defendants can prove that charging the same price for the Shell and Texaco brands was "necessary" to the venture's success. As demonstrated in our opening brief (at 32-37), however, that argument is fundamentally flawed.

Among other things, respondents proceed from the mistaken premise that setting a price for Equilon's gasoline is an "ancillary" restraint that must be separately justified. As the United States explains (U.S. Br. 22-28), "ancillary restraint" analysis only applies to agreements that themselves restrain competition outside of the joint venture, and that therefore must themselves be separately justified. *See Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 210, 224 (D.C. Cir. 1986) (describing an ancillary restraint as "an agreement eliminating competition"). When the alleged agreement does not impose any additional limitation on competition that would exist absent that agreement, no basis exists for requiring separate justification. Rather, it is the agreement that eliminated competition in the first place that is subject to antitrust scrutiny and that must be justified. In this case, that agreement was Equilon's formation as both a production and a marketing venture. The decision as to how that venture's products would be priced is simply the operation of that venture; it is not an additional restraint that can be said to restrain competition in the market and to require scrutiny as an "ancillary restraint."

Contrary to respondents' assertion, this is exactly the approach followed in *BMI*. The Court there did not analyze the pricing of the blanket license as an ancillary restraint. The setting of a price for the license did not create any additional elimination of competition separate from the creation of the blanket license itself. The setting of price was simply the "necessary consequence" of creating the blanket license, 441 U.S. at 21—just as the necessary consequence of forming a venture to both produce and sell gasoline is that a price must be established for that gasoline.

There is an important difference between *BMI* and this case—but it is a difference that further defeats respondents' argument. In *BMI*, the venture members each continued to produce and own their own copyrighted works and "retain[ed] the rights individually to license" those works. 441 U.S. at 11. In contrast, here, Shell and Texaco entirely exited the relevant market and were no longer in competition with each other or with Equilon; and the challenged action—the joint setting of a unified price for the joint venture's gasoline production—concerns the operations of the joint venture itself, not "ancillary" actions of the joint venture partners. Thus, whereas rule of reason analysis remained to be applied to the restraint at issue in *BMI*, here no Section 1 scrutiny is appropriate at all, much less *per se* analysis.

Applying ancillary restraint analysis to a venture's operation of its own business would work a fundamental shift in antitrust jurisprudence. When two companies form a venture that integrates some aspect of their operations, the courts do not condemn that integration as *per se* illegal if the companies cannot show that the integration was "necessary" or that the companies could not function without it. Instead, the courts evaluate the integration under the rule of reason, with the burden on the plaintiff to initially prove that the integration will have anticompetitive effects. It is only if such anticompetitive effects are shown that the courts inquire into whether the benefits of the venture outweigh those effects and whether particular aspects of the venture are

necessary to achieving those benefits. Respondents' approach would fundamentally alter the established inquiry.

Respondents complain (Resp. Br. 12, 16) that "no efficiencies, cost savings, or competitive benefits" resulted from the alleged price fixing and that the venture "could have functioned . . . perfectly well" without it. But respondents cite no authority for the proposition that joint venturers must show that the particular manner in which the venture conducts its business is "necessary." As discussed in our opening brief (at 36), any such standard would wreak havoc on joint ventures, because it would be virtually impossible to show that charging one price is any more "necessary" than charging any other price—or that selecting one output level, or one particular supplier, is any more "necessary" than selecting a different one. Respondents have no answer for this point. Nor do they suggest any reason why Equilon's pricing would be any less subject to *per se* condemnation under their approach if Equilon had adopted a different pricing strategy. To the contrary, their argument that no cost savings resulted from charging the same price would apply equally to any pricing strategy that Equilon might have adopted. Rather, under respondents' approach, the only apparent means by which petitioners could have avoided *per se* condemnation would have been to remove the pricing function from Equilon and effectively unwind the entity as a marketing venture. If this approach were accepted, not only would Section 1 scrutiny be applied where none is justified, the governing rule of reason standard for evaluating a venture's formation would also effectively be supplanted with a *per se* rule of illegality for marketing of a joint venture's products.

Respondents quote the Ninth Circuit's suggestion that the result might be different if petitioners had merged their brands into "one collective brand." Resp. Br. 49 (quoting Pet. App. 27a). But this assertion only confirms the irrationality of respondents' position—and its lack of connection to any valid antitrust policy. If competition were

thwarted by selling gasoline under two brands at the same price, it would be equally thwarted by selling gasoline under a single brand at a single price. Either way, petitioners would be agreeing on the price of gasoline that was sold. Despite respondents' disclaimer, there is no logical stopping point for their argument. It would unavoidably preclude joint ventures from setting selling prices for their own products, and thus effectively ban beneficial, efficiency-enhancing collaborations that are vital to the economy. *See Polk Bros., Inc. v. Forest City Enters.*, 776 F.2d 185, 188 (7th Cir. 1985) ("The war of all against all is not a good model for any economy. Antitrust law is designed to ensure an appropriate blend of cooperation and competition, not to require all economic actors to compete full tilt at every moment.").

II. PRICING OF A JOINT VENTURE'S OWN OUTPUT BY THE VENTURE OR ITS OWNERS IN A MARKET IN WHICH THE OWNERS DO NOT COMPETE IS NOT CONCERTED ACTION SUBJECT TO SECTION 1.

As part of their erroneous effort to apply the *per se* rule to the pricing of a joint venture's output by the venture or its owners, respondents urge (Resp. Br. 22-31) that joint ventures like Equilon are really not single entities and thus should not be treated as such for antitrust purposes. This argument is also flawed at every turn.[1]

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[1] Contrary to respondents' assertion, petitioners argued in the court below that Section 1 should not be applied here (*e.g.*, Appellees' Brief, filed January 30, 2003, at 18, 21; Petition for Rehearing, filed January 22, 2004, at 2, 14), and the court of appeals ruled on the issue (Pet. App. 19a-20a n.11). Indeed, the applicability of Section 1 is precisely the issue that divided the majority and the dissent below. *Compare* Pet. App. 6a & n.4, 19a n.11 (majority op.) (finding concerted action), *with id.* at 31a (Fernandez, J., dissenting) (concluding that Equilon should be viewed as "a separate entity"). Petitioners also made this argument in the

A. This Court Has Not Applied Section 1 To A Joint Venture's Operation In A Market In Which Its Owners Do Not Compete.

Respondents point out that this Court has a "long history of applying the antitrust laws to joint ventures." Resp. Br. 23. That is of course true, and the antitrust laws have been applied to this venture—*i.e.*, when the FTC and the states reviewed its formation and found it to be permissible. But the antitrust laws have not been applied to regulate the pricing decisions or other operational activities of joint ventures—at least not in the manner respondents urge here.

The Court's joint venture cases have involved either scrutiny of the venture's formation, *e.g., Timken,* 341 U.S. 593, or scrutiny of a restraint on non-venture conduct or conduct in a market in which the venture owners remained in competition. *E.g., FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447 (1986); *Northwest Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284, 295 (1985); *NCAA*, 468 U.S. 85; *Maricopa County,* 457 U.S. 332; *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679 (1978). None of these circumstances is at issue in this case.

All that is at issue here is an integrated joint venture's operation of its own business in a market in which the venture owners no longer compete. None of this Court's precedents has applied Section 1 in this context. Indeed, the Court concluded just the opposite in *Maricopa County*, where it observed that a joint venture consisting of companies that have "pool[ed] their capital and share[d] the risks of loss as well as the opportunities for profit . . . is regarded as a single firm competing with other sellers in the

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petitions for certiorari (Texaco Pet. 10-13, 18-22; Shell Pet. 15-16), and respondents did not assert in their opposition that the argument had not been presented below. Any contention that petitioners' argument is not properly before this Court is thus erroneous and has been waived. *See, e.g.*, Sup. Ct. R. 15.2; *Knowles v. Iowa*, 525 U.S. 113, 116 n.2 (1998).

market," with the result that "a price-fixing agreement among the [partners] would be perfectly proper." 457 U.S. at 356-57.

Contrary to respondents' argument (Resp. Br. 22), this is not a matter of according joint ventures "special antitrust status." Rather, it is simply applying to joint ventures the same Section 1 standards that apply to all firms. Section 1 applies only to conduct that involves "a sudden joining of two independent sources of economic power previously pursuing separate interests"—a "merging[] of resources" that "increases the economic power moving in one particular direction." *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 769, 771 (1984). When two firms have already combined their businesses and no longer compete in the relevant market, a decision about the prices the new entity will charge for its products is not a "merging of resources" and has no effect on economic power. It is merely the operation of the new entity's validly formed business. While Section 1 applies to the formation of the joint venture, it does not apply to the ongoing operation of the entity once formed.

B. Applying Section 1 To A Venture's Ongoing Operational Decisions Would Frustrate, Not Further, Sound Antitrust Enforcement.

In response, respondents assert (Resp. Br. 29) that "sound public policy" supports applying Section 1 here. But they have no coherent response to the point that subjecting a joint venture's ongoing daily operations to separate antitrust scrutiny would be completely unworkable. While they assert (*id.* at 28) that identifying which joint venture activities should be treated as concerted action and which should not would be more difficult than just calling everything concerted action, the distinction in the Sherman Act between concerted action and single firm conduct is well-established and exists for an important reason: business decisions that do not restrain otherwise existing competition do not

threaten competition, which is best served by allowing businesses to operate without fear of their "every action [being subjected] to judicial scrutiny for reasonableness." *Copperweld*, 467 U.S. at 775. *See* VII Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1462, at 192 (2d ed. 2003) ("[S]ubjecting virtually every decision made within a single firm to Sherman Act § 1 scrutiny would not only overtax the limits of our antitrust enforcement institutions, it would also involve judges and commissioners with the daily business decisions of every firm.").

Contrary to respondents' argument (Resp. Br. 30), recognizing that Section 1 does not apply to a joint venture's conduct of its own business does not mean that antitrust enforcers must "anticipate every conceivable restraint in which the venture could engage post-formation." *Id.* If the venture participants later change the scope of their venture, or adopt new restrictions on their non-venture conduct, such decisions would be subject to Section 1 scrutiny on the same basis as the original formation decisions. But there is no need for separate Section 1 scrutiny of the ongoing operation of the business that the venture was formed to conduct—nor for antitrust regulators to try to predict the specific pricing strategy that the joint venture may adopt or the output decisions that it may make. The protection against any anticompetitive consequences flowing from such pricing or output decisions is not ongoing scrutiny of those individual decisions for "reasonableness." *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 25 (1st Cir. 1990) (Breyer, J.) ("antitrust courts normally avoid direct price administration"). Rather, the protection against any such anticompetitive consequences is the rigorous evaluation of market conditions in which the business will operate that is part of a traditional rule of reason assessment of the permissibility of the joint venture in the first place. Here, the FTC and the states performed just such a rigorous evaluation when, applying the standards of Section 1 of the Sherman Act and Section 7 of the Clayton Act, they examined the

markets in which Equilon would operate and concluded that (with certain divestitures) Equilon would lack the ability to engage in supracompetitive pricing. VII *Antitrust Law* ¶ 1464, at 214 ("legal permission for a particular merger under the rather stringent prophylactic standards of Clayton Act § 7 necessarily expresses the judgment that the merger presents an insufficient anticompetitive threat to warrant condemnation"); *see* U.S. Br. 17 (confirming that, in reviewing Equilon's formation, the "FTC applied the antitrust enforcement standards that the Justice Department and the FTC apply to mergers").

The lack of merit in respondents' position is perhaps best illustrated by their assertion that, if petitioners had wanted to avoid lawsuits like this one, "they could have merged, as they well knew." Resp. Br. 31. Respondents thus concede that it would have been perfectly lawful for a merged company to decide to charge the same price for Shell- and Texaco-branded gasoline. The competitive consequences of that situation, however, would be no different from what actually occurred here—except that a complete merger would have eliminated competition between Shell and Texaco to an even greater degree by extending to other markets beyond just domestic gasoline. The antitrust laws do not and should not prefer mergers to joint ventures; and they certainly should not be construed to provide unnecessary incentives for the elimination of competition where economic benefits do not warrant it.

III. NEITHER THE COMPETITION BETWEEN SHELL AND TEXACO IN OTHER MARKETS NOR THE POTENTIAL UNWINDING OF THE VENTURE, NOR THE NON-COMPETE AGREEMENTS, JUSTIFY APPLYING EITHER SECTION 1 OR THE *PER SE* RULE TO THE PRICING OF EQUILON'S PRODUCTS.

In arguing for the application of both Section 1 and the *per se* rule, respondents point out (Resp. Br. 24-27, 31-32)

that Shell and Texaco did not end competition between themselves in other markets, that the venture could be unwound, and that Shell and Texaco entered into non-compete agreements with respect to the market in which Equilon was to operate. From these facts, respondents assert (Resp. Br. 32) that the pricing of Equilon's own products might facilitate "collusion and pricing uniformity" regarding Shell's and Texaco's non-venture products or their own gasoline upon the venture's termination, or otherwise justify application of Section 1 and the *per se* rule to the pricing of Equilon's products. This argument is also unsound.

First, in advancing this argument, respondents abandon the Ninth Circuit's reasoning. The Ninth Circuit concluded that Section 1 applies here, not because of any competition between Shell and Texaco in other markets, but because Shell and Texaco supposedly "agreed in advance" of Equilon's actual formation on the pricing for the two brands. Pet. App. 19a n.11. For the reasons explained in our opening brief (at 23-24), that ruling was erroneous; and, by now focusing on arguments about other markets and products or on the non-compete agreements, respondents are revealing that they understand they cannot defend that ruling.

Second, respondents presented no evidence that pricing decisions about domestic gasoline had any relation to, or any potential to affect, pricing of such disparate products as marine lubricants, sulfur, heavy fuel oils, coke or any of the other products Shell and Texaco sold outside the venture. Nor is there any evidence suggesting that pricing during the venture had any effect on—or potential to affect—post-venture gasoline pricing. On these and other issues, respondents and their amici argue as though the case had been dismissed on the pleadings, rather than the district court having granted summary judgment after full discovery on all liability issues. The question at this stage is not what respondents might have proved; rather, the question is what they in fact proved by sufficient evidence to withstand summary judgment.

Third, even if there were evidence (or reason to believe) that pricing of the joint venture's products could affect pricing of non-venture products, that would not be a proper basis for applying Section 1 to the pricing of Equilon's products—and certainly not for condemning it as *per se* illegal. The alleged adverse effect on competition does not flow from any decision to charge any particular price; the supposed adverse effect would exist regardless of whether Equilon charged the same or differing prices for the two brands. Either way, Equilon or its owners would be establishing relative prices for the gasoline, which price would then (under respondents' theory) be a basis for "facilitating" similar pricing of other products. The issue, then, is not how Equilon priced its gasoline, but rather whether it was proper for Equilon (or its owners) to set any price at all for that gasoline—*i.e.*, whether Equilon could legitimately be formed as both a production *and* marketing venture. While that question may be subject to Section 1 scrutiny, the scrutiny is not of the propriety or "necessity" of any particular pricing decision (as respondents urge and the Ninth Circuit held). Nor would the question be evaluated under the *per se* rule. The inquiry would instead be a rule of reason inquiry into the propriety of Equilon's formation as a marketing venture, under which any anticompetitive effects must be proved (not conjectured) and carefully balanced against the procompetitive benefits created by the venture (which are unchallenged here). *Cf. Copperweld*, 467 U.S. at 768. That is precisely the inquiry that the FTC and four state attorneys general conducted at the time that Equilon was formed. Neither court below questioned the validity of Equilon's formation as a marketing venture, and respondents expressly abandoned below any challenge under the rule of reason, whether to the venture's formation or otherwise.

Fourth, respondents also apparently still assert (Resp. Br. 33) that setting the same price for the two brands restrained competition between the brands while the venture was in existence. But that is the very intra-enterprise conspiracy

theory that this Court rejected in *Copperweld*. The competition with which Section 1 is concerned is competition between "independent sources of economic power," *Copperweld*, 467 U.S. at 771, not competition between brands under the exclusive control of a single entity. *See* U.S. Br. 14. Once the decision to combine the two brands under common ownership is found permissible, no legitimate antitrust purpose is served by subjecting the daily pricing behavior of the combined entity to continual scrutiny. If respondents' theory of competition and antitrust law were accepted, validly merging companies that wish to continue to use their existing brand names could always be required to maintain competition between those brands. That is not the law, nor should it be. *See* W. Stephen Smith, *Can a Fully Integrated Joint Venture Be Per Se Unlawful,* 19 Antitrust 52, 55 (Spring 2005) ("A decision by Equilon and Motiva to charge the same price for Shell and Texaco gasoline is no different than a decision by Hewlett-Packard to charge the same price for HP and Compaq brand computers.").

Fifth, the fact that Equilon could be terminated (and later was terminated as a joint venture when Texaco merged with Chevron) does not change this analysis. The expected duration of the venture is relevant in a rule of reason analysis of the venture's formation, since a venture scheduled to last only for a brief period might not be able to achieve real efficiencies that could outweigh any potential anticompetitive consequences. But if the venture is valid under the appropriate rule of reason analysis (both the FTC and the district court so found here, *see* U.S. Br. 14 n.8; Pet. App. 58a-59a, and respondents below abandoned any contrary claim), the fact that the venture may later be unwound does not justify any further Section 1 scrutiny—just as it would not justify further Section 1 scrutiny of the internal operation of a merged company (which can also be unwound). Once validly formed, joint ventures (and merged companies) must be free to conduct their validly formed businesses as would other entities. *See also* VII *Antitrust Law* ¶ 1475, at 304

("[O]nce antitrust law deems the creation of an organization to be lawful, it would be inconsistent to prevent it from functioning by characterizing its normal operations as *per se* or otherwise unlawful conspiracies.").

Finally, contrary to respondents' argument, there is no legal basis for suggesting (Resp. Br. 24) that the non-compete agreements are themselves *per se* illegal. Shell and Texaco did not merely agree to not compete with each other while remaining independent participants in the relevant market without any integration. Instead, their non-compete agreements accompanied their valid efficiency-enhancing integration of all of their domestic gasoline refining and marketing assets. In such circumstances, non-compete agreements are both normal and the classic example of an ancillary agreement that is not illegal *per se* but instead evaluated under the rule of reason. *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 729 n.3 (1988) ("The classic 'ancillary' restraint is an agreement by the seller of a business not to compete within the market."). Respondents disclaimed any such challenge when they abandoned any rule of reason claim below. *See* Pet. App. 7a ("plaintiffs disclaimed any reliance on the traditional 'rule of reason' test").

IV. THE ALTERNATIVE "QUICK LOOK" ARGUMENTS OF RESPONDENTS AND THEIR AMICI ARE MERITLESS.

Respondents and their amici alternatively assert that at least "quick look" analysis should be applied. Resp. Br. 41; AAI Br. 10-23. These arguments are similarly meritless.

A. Equilon's Operation Was Not Obviously Anticompetitive.

"Quick look" treatment requires that "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question have an anticompetitive effect on customers and markets." *Cal. Dental Ass'n v. FTC*, 526 U.S. 756, 770 (1999). There must

be a "great likelihood of anticompetitive effects [that] can easily be ascertained." *Id.* Respondents do not and cannot come close to meeting that standard.

There is no reason to imagine here, much less any evidence, that the pricing of a joint venture's own product (whether at the same or different prices) will have any anticompetitive effect—let alone that there is a "great likelihood" of such an effect. The FTC reached just the opposite conclusion when, after an extensive investigation, it permitted the venture to be formed as a production and marketing venture conditioned on limited divestitures which "alleviate[d] the alleged competitive concerns arising from the Joint Venture." FTC, *Analysis to Aid Public Comment,* 62 Fed. Reg. 67,868, 67,869 (Dec. 30, 1997). Since there is no basis for suggesting that the federal government's designated antitrust enforcement agency for this transaction (along with the attorneys general of four states) lacks a "rudimentary understanding of economics," it is hard to imagine a less likely candidate for "quick look" treatment than this joint venture.

Respondents' attempted analogy to Professor Areeda's hypothetical joint selling arrangement between GM and Ford, Resp. Br. 20-22, only confirms this point. Professor Areeda's argument was that the formation of such a venture would be unlawful because it would merely be a vehicle for establishing the price for separately produced and owned goods, without achieving any meaningful efficiencies. The hypothesized venture did not involve any integration or sharing of risk. Here, by contrast, Equilon was a full integration of Shell's and Texaco's production and marketing operations that was reviewed at length by federal and state regulators and found proper. "Quick look" is inapplicable.

Quick look liability is also improper even if, as the American Antitrust Institute ("AAI") urges, respondents could be thought to be challenging the Brand Management

Protocol, rather than the specific prices that Equilon charged. The AAI asserts that the Brand Management Protocol, which merely established the conditions under which the Shell and Texaco brands were licensed to Equilon, imposed an "unduly restrictive structure" on Equilon that impaired Equilon's "ability to compete in the market" by preventing it from pursuing a profit-maximizing strategy. AAI Br. 4, 16. There is of course no evidence that the Brand Management Protocol had anything to do with the decision about how Equilon's products would be priced or that, if it did, Equilon's pricing strategy was not in fact profit maximizing. But, even if there were such evidence, it would still not support a claim that the Brand Management Protocol or Equilon's pricing was anticompetitive, let alone so obviously anticompetitive that it could be condemned on a quick look basis without full analysis.

Numerous companies pursue business strategies that may not always maximize their profits. That does not mean that a company's operation is anticompetitive or that the strategy violates the antitrust laws. Nor, in the case of a joint venture, does it mean that the venture is invalid as not being sufficiently "efficient" or "vigorous" (AAI Br. 6, 12) in its behavior. Unless the venture possesses market power (and the FTC and four state attorneys general concluded that, as formed, Equilon would not), any internal constraints on its operational decisions—whether "unduly restrictive" or otherwise not "profit-maximizing"—would at most harm only the venture, not competition. If respondents wished to argue otherwise, it was their burden to adduce evidence proving as much. They did not do so.

The AAI's unsupported speculation (AAI Br. 6, 17) that the Brand Management Protocol was adopted (and may have been applied) to protect the venture owners' interests outside the venture is similarly irrelevant. Even if that were true, there would be nothing obviously anticompetitive about venture owners acting to preserve the value of their assets outside the venture. To the contrary, it is just as likely that

doing so would have "a net procompetitive effect, or possibly no effect at all on competition." *Cal. Dental*, 526 U.S. at 771.

B. Respondents Have Not Shown Any Actual Anticompetitive Effects.

Finally, respondents err in suggesting (Resp. Br. 45) that "demonstrable anticompetitive market effects" exist here because gasoline prices rose in early 1999. They presented no evidence that the price increases had anything to do with Equilon or its pricing strategies. They assert only that crude oil prices were stable or dropping at that time. Even if that were true, however, gasoline prices are not merely the product of crude oil costs but are affected by numerous other variables, including consumer demand and refining and transportation constraints. Respondents have not attempted to control for these variables; and thus the inferences that they seek to draw are legally spurious ones. Indeed, federal investigators examining the 1999 West Coast price increases concluded that they were primarily the result of disruptions in supply caused by a refinery explosion in Northern California and subsequent outages in three other California refineries. *See* U.S. General Accounting Office, *Motor Fuels: California Gasoline Price Behavior*, at 12-13 (April 2000). In short, because there is no proof that the market-wide price increases were causally linked to the internal pricing decisions of a single actor in that market, the price increases to which respondents point are legally meaningless. *Cf.* XI H. Hovenkamp, *Antitrust Law* ¶ 1914, at 351 (2d ed. 1998) ("[I]n any case where proof of an output reduction substitutes for a showing of power, causation must be established. The mere fact that output declines after a restraint has been put in place does not mean that the restraint contributed in any way to the output reduction.").

CONCLUSION

The judgment of the Ninth Circuit should be reversed.

Respectfully submitted,

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